

Section II Production

Chapter 17 Portfolios

17.1

Background and Overview

This chapter provides an overview of HUD's policy with respect to portfolios - multiple projects with the same ownership and supersedes previous guidance in HUD Housing Notice H 01-03: "Review of Health Care Facility Portfolios and Changes to the Section 232 Programs" issued in 2001, and Mortgagee Letter 00-42: "Headquarters Review of Certain Applications for Section 232 Mortgage Insurance" issued in 2000.

This policy enhances the ability of the Office of Residential Care Facilities (ORCF) to: manage risk in an ever-changing residential healthcare industry, ensure that the General Insurance Fund remains stable, and continue to support owners and operators of residential care facilities around the country.

Since 2000, HUD has seen an increase in the number of applications for financing of multiple projects under the same ownership and/or operating structures. This grouping of projects also referred to as portfolios, with common Borrowers and related or non-related operators, effectively concentrate a large amount of credit risk on a single parent entity. The risk profile of portfolios requires that HUD develop comprehensive measures to identify and mitigate the potential adverse impact of this risk.

In 2001 with Notice H 01-03, HUD prescribed a corporate credit review for midsize and large portfolio projects in order to assess the credit risk of the parent corporate or holding entity. HUD has always required that the lender submit a separate mortgage insurance application for each facility and that each project must individually meet HUD's underwriting requirements. HUD has also determined that for portfolios the overall financial, operational, regulatory and legal condition must also be evaluated to ensure that both the owners and operators have the experience and the financial strength to successfully operate a portfolio of residential healthcare facilities.

Portfolio corporate credit reviews and master leases (see Production, Chapter 13) are the primary tools ORCF uses to identify and mitigate concentration risk associated with portfolio projects.

Ongoing Asset Management of Portfolios Post-Endorsement

Lenders for portfolio projects should be advised that they now have a continuing obligation to monitor the performance of both individual portfolio projects as well as the financial condition of parent entities that own and/or operate portfolio projects after loan closing and until the loan is repaid. ORCF will continue to develop its oversight and monitoring asset management system for parent entities as a means to monitor project owners and operators, identify potential problems and work with lenders in a preemptive manner with needed risk mitigation efforts.

17.2

Terms and Concepts

Portfolio: Two or more borrower entities that are under common ownership and/or common control.

Common Control: Is exhibited by any individual(s) or entity(ies) that controls the Borrower and/or operator regardless of the percentage of ownership interest, so long as the individual(s) or entity(ies) comprise each Borrower and/or operator. Affiliated residential care facilities and/or healthcare operating entities will be grouped into a portfolio if they share common control as defined here. The type of corporate credit review will depend in part on the size of the combined mortgage amount of the portfolio (see Section 17.4 below).

Single Asset Entity: For each individual project, the mortgaged property shall be the only asset of the Borrower and Operator (please see Production, Chapter 2.5.B and 2.5.C for SAE requirements).

Affiliates/Affiliated: Any person or business concern that directly or indirectly controls the policy of a principal or has the power to do so.

17.3

Criteria for Portfolio Corporate Credit Review

A portfolio corporate credit review is required for all midsize and large portfolios (See Section 17.4 below). Portfolio corporate credit review procedures apply to owners and operators of residential care facilities and their affiliates in the following circumstances:

1. An application for mortgage insurance for purchase or refinance of an existing facility, pursuant to Section 223(f);
2. An application for mortgage insurance involving new construction or substantial rehabilitation pursuant to Section 232 NC/SR;
3. A transfer of physical assets (TPA); or
4. A change of control of facility operators. This will generally be a change in the lessee of a facility, a change in the operating license holder, and/or a change in the entity that

contracts directly with residents. In some circumstances, a management agent may fill one or more of those roles and could trigger a change of control review if the management agent assumes healthcare operational responsibility.

Portfolio reviews are not required for applications under Section 223(a)(7).

17.4

Portfolio Size Classifications

Portfolios are classified based on the combination of number of facilities and total mortgage amount reflected in the applications for mortgage insurance submitted within any rolling 18-month timeframe that begins when the first application is assigned to an ORCF underwriter. In the case of a TPA or change in control of facility operations, portfolio size classification will be based on the number of FHA-insured individual mortgages and the 18-month window will begin when the ORCF asset manager begins processing.

The submission of an application creates an open window for portfolio consideration. The window remains open for 18 months following the start of processing of the most recent application. Thus for multiple submissions, the cumulative open window may be longer than 18 months from the first application to the last.

This 18-month timeframe may be expanded, at the discretion of ORCF where necessary, to accomplish the intent of a complete portfolio review and to fully evaluate the risk to the General Insurance Fund. If the management of an accepted portfolio wishes to increase the number of projects and/or the total approved mortgage amount after the 18-month window, then ORCF will conduct an updated corporate credit review. Further, if 18 months or more passes after the issuance of a portfolio acceptance letter without any individual applications being submitted, and if management then decides it wants to begin submitting applications, ORCF will conduct an updated corporate credit review.

Portfolios shall be classified as follows:

A. Small Portfolio*:

1. Up to 49 facilities and aggregate mortgage amount less than or equal to \$90,000,000.
2. A portfolio corporate credit review is not required.
3. The Certification of Multiple Projects is required.

**The portfolio corporate credit review is not required for small portfolios; however, the projects in the small portfolio will be required to enter into a master lease covering each ownership and operating entity for all projects included in the portfolio.*

B. Midsize Portfolio:

1. Up to 49 facilities and total mortgage amount greater than \$90,000,000 and less than or equal to \$250,000,000.
2. Portfolio corporate credit review and the Certification of Multiple Projects is required.

C. Large Portfolio:

1. 50 or more facilities and/or an aggregate mortgage amount greater than \$250,000,000 and less than 5% of the current unpaid principal balance of the entire portfolio of active Section 232 loans.
2. Portfolio corporate credit review and the Certification of Multiple Projects is required.

Portfolio Classifications

#of Facilities / Total Mortgage	2 – 49	50+
$\$0 < x \leq \90M	SMALL	
$\$90\text{M} < x \leq \250M	MIDSIZE	
$\$250\text{M} < x < 5\% \text{ of UPB}$	LARGE	

ORCF will not approve portfolios with an aggregate mortgage amount in excess of 5% of the current unpaid principal balance (UPB) of the entire portfolio of active Section 232 loans. The current UPB amount may be obtained upon request from the Director of the ORCF.

17.5

Certification of Multiple Projects

The lender will obtain from the borrower for both current and proposed residential care borrowers and their Affiliates (whether as a borrower, sponsor, or principal as defined by HUD Previous Participation — 2530/APPS) who participates or proposes to participate in an application for Section 232 mortgage insurance, a TPA, or change in ownership or control of facility operations a Certification of Multiple Projects, found as part of the Consolidated Certification – Borrower. The purpose of this Certification is to ensure that HUD is fully aware

of all residential care and/or healthcare projects that may be submitted as part of a portfolio application and/or any other FHA-insured residential care facilities with common principals to the current application. It is essential that HUD have this information to ensure that applications are processed properly and for accurate classification in the asset management system.

The Certification of Multiple Projects shall provide the following information:

1. The number, location, and estimated mortgage amount of all facilities that are or will be included in applications for FHA mortgage insurance that will be submitted within the 18-month open window as specified in Section 17.4;
2. Each certifying borrower's, principal's, or affiliate's roles in the proposed project(s);
3. All current FHA-insured or HUD-held loans (include name and FHA number) for which the certifier is a Borrower, operator, or other principal as defined by their HUD Previous Participation Certificate (APPS) except that certifications submitted with an (a)(7) application) do not need to be included; and
4. Provide on the signature page of the Certification of Multiple Projects that the information on the certificate is accurate and include the following: "HUD will prosecute false claims and statements. Convictions may result in criminal and/or civil penalties (18 U.S.C. §§ 1001, 1010, 1012; 31 U.S.C. §§ 3729, 3802; 24 CFR 200.62)."
5. Provide on the signature page of the Certification the following: This Certification has been made, presented and delivered for the purpose of influencing an official action of the FHA, and of the Commissioner, and may be relied upon by the Commissioner as a true statement of the facts contained therein.

For midsize and large portfolios, submit the Certification of Multiple Projects in the portfolio corporate credit review package. For small portfolios, submit the Certification of Multiple Projects with each individual mortgage insurance application.

All applications for financing, refinancing, TPA, or change in facility operators of two or more Section 232 projects, or one project where the proposed principals already participate in other properties with mortgage insurance under Section 232, must include the certifications in their submission.

17.6

Portfolio Corporate Credit Review

Description

To assist ORCF in reviewing midsize and large portfolio qualifications, the lender must submit the information required for a portfolio corporate credit review. Lenders shall consult with the Director of ORCF regarding the financial, legal and organizational structure of a proposed portfolio submission at the beginning of the process of defining the scope of the portfolio corporate credit review. This communication with ORCF is necessary to ensure that the corporate credit review addresses the relevant information and risk factors. ORCF will determine the subject of the portfolio corporate credit review as the entity (both ownership and operational) that may potentially create a material risk to the projects and to the General Insurance Fund. ORCF will review all materials submitted in the portfolio corporate credit review and determine whether the portfolio is an acceptable risk to the General Insurance Fund based on operation and ownership experience, financial strength, quality indicators, and any pending legal issues including the jurisdictional regulatory environments. The Office of Risk Management (ORM) and the Office of General Counsel (OGC) are also participants in this review process.

ORCF will require a mortgage reserve fund for all midsize and large portfolios and may impose additional requirements and/or limitations on the portfolio as well as other risk mitigants. These additional requirements may include, for example, reserves for capital improvements, a higher mortgage reserve fund, lower loan to value requirements, professional liability insurance reserve funds, third party risk management programs for facility operations and quality of care, and limitations on cash distributions until certain sustained cash flow multiples are met.

The lender may not submit individual applications as part of a midsize or large portfolio to ORCF for processing until the portfolio acceptance letter, signed by the Office of Healthcare Programs (OHP) Deputy Assistant Secretary, has been issued.

The portfolio corporate credit review materials must contain the information identified in Section 17.7 and be presented following the list in Section 17.8 below. The complete package must be submitted electronically. If separate hard copies are delivered to HUD, all materials must be labeled and tabbed according to the outline.

The information in this package must be compiled by the borrower or the lender; however, the lender or borrower may engage a public accountant or other consulting firm with appropriate expertise to assist with the compilation of the information. The lender must notify HUD of what entity or entities prepared or substantially assisted in the preparation of the corporate credit review and any relationship that exists between the lender and the other parties preparing the documentation or involved in the transaction. ORCF may provide templates for inputting the portfolio corporate credit review contents as listed in Section 17.7 below.

The professional liability insurance (PLI) review and the accounts receivable (AR) financing review (if applicable) will occur in conjunction with the portfolio corporate credit review.

Any owner or operator of a healthcare facility or their affiliate or renamed or reformulated company that has *filed for, is in, or has emerged from* bankruptcy within five years period preceding the date that such lender submits information to HUD as part of the mortgage insurance process *is not eligible to participate* in any manner in a facility which seeks to have its mortgage loan insured through the Section 232 program.

A project in bankruptcy that is acquired by a non-identity-of-interest owner in good standing may be eligible for mortgage insurance, subject to HUD review. HUD will review updated financial information (post-bankruptcy) and the new senior management team.

17.7

Portfolio Corporate Credit Review Contents

A. Description of the Company (Reviewed Entity):

1. Narrative description of operations and products;
2. The management policies (including a detailed statement with the mission, vision, and financial policies);
3. The legal structure of the company (including an organizational chart);
4. An explanation of the management structure (including a management organization chart);
5. The strength of management (as measured by their biographies and industry experience);
6. A list of officers and directors or trustees of the company including names, Social Security Numbers or Employer Identification Numbers, addresses and titles of positions;
7. Current resumes on the company and principals and operating officers of the company;
8. Credit reports on the company and its operating officers (as provided by outside research firms);
9. Discussion of outstanding Federal or State litigation involving criminal actions, alleged fraud or abuse, any administrative or court complaints alleging fair lending or fair housing discrimination; and/or other actions that may have an adverse financial or regulatory effect on the facility(ies) and

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282 10. If available, a report, including rating, prepared by a rating agency (such as Standard
283 & Poor's or Fitch);
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285 11. Notify HUD if the owner of the proposed facilities to be financed have in the past two
286 years been in negotiations to sell the portfolio entity or are contemplating a sale of the
287 facilities or the company within the next three years.
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289 **B. List of All Facilities Owned by the Borrower and Operated by the Operator (including**
290 **those facilities that are not part of the portfolio):**
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- 292 1. Legal names of the real estate and operating entities;
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294 2. Location of each facility by city and state;
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296 3. Number of beds and/or units;
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298 4. Current debt attributed to each facility and the basis for allocation;
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300 5. Trailing 12 months revenue for each facility;
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302 6. Trailing 12 months Earnings Before Interest, Taxes, Depreciation, Amortization and
303 Rent (EBITDAR) for each facility;
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305 7. Trailing 12 months occupancy/census data and payor mix for each facility; and
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307 8. Identification of the facilities to be included in the FHA financing.
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309 **C. Financial Summary:**
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- 311 1. Provide the most recent three years of audited consolidated financial statements
312 including income statements, balance sheets, and cash flow statements for the parent
313 entity (ownership and/or operating entity) that is under review. If audited financial
314 statements are not available, the lender may substitute owner certified financial
315 statements. The financial statements and any summaries must include all associated
316 facilities, corporate overhead and other revenues and expenses as well as all notes to
317 the financial statements;
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319 2. Interim financial statements (through the reporting date) including trailing 12 months;
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321 3. Operating and financial forecasts and plans, including corporate strategy and
322 acquisition/disposition/new development strategy (as prepared by management);
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324 4. Financial analysis and cash flow proformas that provide EBITDAR margins,

leverage ratios and cash flows, and base case and worse case running scenarios on future cash flows (as prepared by management and compared to industry benchmarks of performance);

5. Projected cash flow analysis after the FHA refinancing including the anticipated debt service payment for the FHA mortgage. The mortgage payment should include the projected interest rate including the mortgage insurance premium and the correct term of the loan. The cash flow projections should have sensitivity analysis showing effects of reduced occupancy, lower government receivables, and higher than anticipated expenses.
6. Corporate debt structure including terms, rates, conditions and payment dates of all long and short-term debts and current debt obligations and standby credit instruments and violations of loan covenants that occurred in the past two years;
7. List of derivatives obligations including termination dates, maximum risk exposure, and interim payment requirements for swaps, credit derivatives and other derivative obligations. Include current market values and prepayment penalties if any; and
8. Capital/equity structure of the firm.

D. Operations:

1. Summary of three years of consolidated census data including beds/units available, beds/units occupied, and payor and quality mix;
2. Summary of three years of average daily rate reimbursement by payor type;
3. Description, breakdown and amount of ancillary revenue;
4. Management fee as a percent of revenue (if applicable); and
5. Provide information on therapy services provided by a non-related third party, if applicable.

E. Professional Liability Insurance and Risk Management:

1. Evidence of PLI coverage and supporting documentation in compliance with Production, Appendix 14.1~~HUD Housing Notice H-04-15 or its successor~~;
2. Six-year loss history and calculation of dollar amount of claims per bed per year for all properties, including the non-HUD properties that will not be included in the portfolio;

3. Narrative of company's risk management and loss prevention policies;
4. Summary of State licensing surveys [inspection reports] for the past three years that address:
 - a. Quality of care issues;
 - b. Average citations for each facility showing both G and above and as compared to the state average in each state.
 - c. Citations of any previous uncorrected findings (rare); and
 - d. Civil money penalties imposed on the site.
5. Parent or captive actuarial statements if available;
6. Audited financial statements of the captive (last three years), if applicable;
7. Provide information on all ongoing or anticipated Qui Tam suits and/or State/Federal investigations on Medicare fraud or serious quality of care issues and any other material legal litigation;
8. CMS Star Ratings and CMS provider numbers for each skilled nursing facility; and
9. A list of any facilities on the CMS Special Focus Facilities list under the PLI.

F. Accounts Receivable Financing (if applicable):

1. Evidence that any existing or proposed AR financing is in compliance with HUD requirements, including separate AR lines for FHA and non-FHA-insured facilities;
2. Name of AR lender; and
3. Terms and limits of the loan.

G. Other Lines of Business

The lender will review and analyze the financial condition of all other properties, business entities (for example, company-owned rehabilitation services), and lines of business under common control by the parent entity but are not being financed with FHA mortgage insurance. The review will include details of the financial relationships between the business entities and the proposed FHA portfolio projects, as well as an analysis of net cash flows, debt service coverage, and credit worthiness of the entity and its owner. The review is to determine event risk of the non-FHA pool of assets and its potential adverse impact on the FHA pool of assets.

If a public accountant, consulting firm, and/or lender identifies issues that may create financial or operational risk and could materially impact the FHA-insured assets, then the

lender or his designee will perform a more in-depth analysis. The portfolio corporate credit review submission will provide this information to HUD along with the lender's analysis of all relevant information and recommendations.

H. Certification of No Investigation, Judicial or Administrative Action

The ~~lender-Borrower and Operator~~ must certify to HUD that the subject of the corporate credit review, a parent, affiliate, or subsidiary thereof, and/or the operator is not the subject of an ongoing investigation or judicial or administrative action involving any Federal, State, municipal and/or other regulatory authority, which may have a detrimental impact on the financial condition or jeopardizes any facility's license and/or the provider agreements. Further, the lender will be required to certify at the time of closing that from the date of the portfolio acceptance letter through the date of final closing there have been no material adverse change in the financial or operational position of the portfolio subject owner and/or operator. OGC will evaluate any active investigations or litigation to determine whether or not they pose a serious risk to the portfolio such that processing should be discontinued or placed on hold.

17.8

HUD Documentation to be Submitted for a Portfolio Corporate Credit Review

For those portfolios requiring a portfolio corporate credit review, the submission package must contain the following items in addition to the information required in Section 17.7 above. Please ensure that all hardcopy materials are labeled, tabbed, and following this format. Submit this package to the Director of ORCF.

1. The Certifications of Multiple Projects as described in Section 17.5.
2. Portfolio corporate credit review and all supporting documentation as described in Section 17.7.
3. HUD Previous Participation (Form HUD 2530 or electronic APPS submission) on the owner, the operator and their affiliates.
4. Explanation of any intent to reallocate base rent (Owner may reallocate base rent allocated to each real property covered by a master lease so long as the total aggregate amount of base rent for all the leased premises is not increased).
5. Master lease submission for facilities in a portfolio transaction (if available). The current master lease provisions are described in Production, Chapter 13.
6. Information demonstrating compliance with liability and property insurance requirements. PLI must be in compliance with Production, Appendix 14.1 HUD Housing Notice H-04-15 or its successor (the PLI review occurs with the portfolio corporate credit review).
7. Information demonstrating that AR financing complies with HUD requirements. (The AR financing review occurs with the portfolio corporate credit review.)

8. Certification that all proposed projects shall meet the Single Asset Borrower Entity standard.
9. Financial Statement Certification.

The submission must clearly identify all proposed portfolio projects, including project name, location, FHA number and mortgage amount to be requested, if known. ORCF understands that such a list may be preliminary and subject to change. Also, for ORCF planning purposes, the lender should provide a preliminary schedule and timing of individual application submissions.